No. 18674

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERT H. NEWTON and GENEVIEVE NEWTON,

Appellants,

vs.

NEW YORK LIFE INSURANCE COMPANY, a corporation, MANUFACTURERS LIFE INSURANCE COMPANY, a corporation, and DOMINION LIFE ASSURANCE COMPANY, a corporation,

Appellees,

THE DOMINION LIFE ASSURANCE COMPANY, a corporation, MANUFACTURERS LIFE INSURANCE COMPANY, a corporation NEW YORK LIFE INSURANCE COMPANY, a corporation,

Appellants,

vs.

LLOYD STEADMAN and WAYNE H. WENTNER,

Appellees.

OPENING BRIEF FOR APPELLANTS NEWTON.

Gibbs, Morris & Ibanez,
Hervey and Bigler,
1557 Beverly Boulevard,
Los Angeles 26, California,
Attorneys for the Appellants Newton.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Textbooks

No. 18674

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERT H. NEWTON and GENEVIEVE NEWTON,
Appellants,

vs.

NEW YORK LIFE INSURANCE COMPANY, a corporation, MANUFACTURERS LIFE INSURANCE COMPANY, a corporation, and DOMINION LIFE ASSURANCE COMPANY, a corporation,
Appellees,

THE DOMINION LIFE ASSURANCE COMPANY, a corporation, MANUFACTURERS LIFE INSURANCE COMPANY, a corporation, NEW YORK LIFE INSURANCE COMPANY, a corporation,
Appellants,

vs.

LLOYD STEADMAN and WAYNE H. WENTNER,
Appellees.

OPENING BRIEF FOR APPELLANTS NEWTON.

Jurisdiction.

Notice of appeal having been timely filed [R. 69], this Court has jurisdiction to review the decision below [R. 61] pursuant to Section 1291 of the Judicial Code (72 Stat. 348, 28 U. S. C. Sec. 1291), and the venue is properly laid in the Ninth Circuit (73 Stat. 10, 28 U.S.C. Sec. 1294, Subd. 1).

Statement of the Case.

The plaintiff-appellants Newton, husband and wife, alleging that they had suffered actual damages of $199,510.00, brought suit on November 24, 1958 in their home county of Siskiyou, California, against the three defendant life insurance companies, appellees herein [R. 50]. In April, 1958, plaintiffs discovered the falsity of the representations made in selling them a program of "bank loan insurance" [R. 31]. The claimed fraud was similar to the factual situation recently examined by this court in *Anderson v. Knox* (1961), 297 F. 2d 702, cert. den. 370 U. S. 915. See also *Steadman v. McConnell,* as Insurance Commissioner (1957), 149 Cal. App. 2d 334.

Extensive discovery proceedings lasting nearly three years followed removal of the case to the District Court of the Northern District, Northern Division. Finally, the matter came on for a trial of a separate issue of law [R. 49] raised by the separate defense that plaintiffs' action was barred for failure to bring suit within two years after appellee companies had issued their policies in 1954 and previous years. This defense was based upon the "incontestable clause" contained in each of said policies [R. 53-55] which either read:

> "This contract shall be incontestable after it has been in force during the lifetime of the Annuitant for two years from date of issue". [Manufacturers and Dominion. R. 54] or
>
> "This policy shall be incontestable after two years from the date of issue". [New York Life R. 55].

No oral evidence was introduced at the trial of this separate issue.

Two of the appellees, Manufacturers and Dominion, issued only single premium annuity contracts to the plaintiff-appellants [R. 53, 54]. The District Court made a separate conclusion of law as to these annuities, as follows [R. 58]:

> "5. The risks of loss under the single premium annuity interests are imposed primarily upon the annuitants and not upon the issuing companies and therefore the incontestable clauses contained therein are for the benefit of the issuing companies."

The District Court concluded as a matter of law that "the incontestable clauses are for the benefit of the insurers and issuing companies, as well as for the benefit of the insured and annuitants" [R. 57], and that plaintiffs' action was therefore barred against the appellee companies [R. 58, 59]. From the ensuing judgment of dismissal plus $2510.39 allowed as costs [R. 61] plaintiffs have brought this appeal.

Specification of Errors.

The District Court erred as a matter of law in the following respects:

1. In entering judgment that plaintiffs take nothing by their complaint.

2. In concluding that the two-year incontestable clauses barred plaintiffs' complaint and that said clauses were for the benefit of the insuring companies.

ARGUMENT.

I.

The History of the Original Purpose of the Incontestable Clause (to Protect the Insured) Prevents Its Being Construed as a Contractual Limitation Upon the Insured's Right to Recover After Discovery of the Insurer's Fraud.

1. History of the Incontestable Clause.

"* * * the incontestable clause was inspired by the desire of the companies to protect the honest policy holder against the possibility that his statements or innocent misstatements might operate to invalidate a claim brought at his death. The provision was justified on the grounds that such miscarriage of his plans could not, of course, after his death, have his own attention or the benefit of his own explanation and proof of his statement."

"The Life Insurance Contract," by Horne and Mansfield, 2nd ed., N.Y. 1948, p. 188.

"The clause was first used in 1864 and thereafter was voluntarily adopted generally by the insurance industry."

"The Life Insurance Policy Contract" Krueger and Waggoner, Boston, 1953, p. 57.

In Greider and Beadles, *Law and the Life Insurance Contract,* published by Richard D. Irwin, Inc. (1960) the author said at pp. 166-167:

"The incontestable clause was first introduced by life insurance companies on a voluntary basis in the latter half of the 1800's. It was introduced in an effort to counteract a growing attitude of public distrust toward the entire life insurance busi-

ness. The feeling was due largely to the practice of some companies of taking full advantage of the fact that even relatively unimportant misstatements in the application for life insurance, if they were not literally true, gave the companies at that time the legal right to disaffirm the contract. . . .

"The use of the incontestable clause was the company's pledge to the insured and beneficiary that it would not rely on such purely technical grounds to disaffirm its contracts."

The phrase "incontestable clause" has thus become a technical expression in the area of insurance. It is a term of art or insurance shorthand employed to describe the special kind of policy-holder protection that the clause was originally designed to accomplish.

This Court summarized the history of the "incontestable clause" in *Richardson v. Travelers Ins. Co.* (1949), 171 F. 2d 699, 701, 7 A. L. R. 2d 501, saying:

"It is generally agreed that the origin of the clause may be found in the competitive idea of offering to policy holders assurance that their dependents would be the recipients of a protective fund rather than a law suit (citing cases). Too often had an insurer obtained a judicial determination upon maturity of the policy that insured had made an inaccurate statement in his application, or was guilty of fraud which resulted in the avoidance of liability under the policy. The clause remedied this situation by rendering the insurer's promise to perform in accordance with the statements and terms in the policy absolute upon the passing of a spe-

cified time, expressly subject only to the non-payment of premiums. Many states have evidenced their favor toward the incontestable clause by enacting legislation requiring it in life insurance policies."

As Mr. Justice Holmes once said:

"Upon this point a page of history is worth a volume of logic." *N. Y. Trust Co. v. Eisner* (1921), 256 U. S. 345, 349.

The history of the origins of the incontestable clause is indisputable. No court, except the District Court in this case, has ever construed the clause as operating in *favor* of the insurance company and *against* its insured.

The clause has become part of the standard boilerplate of all insurance policies. The tradition has become so strong that many times its insertion has become essentially meaningless. Thus, in the annuity policies issued by the defendants Manufacturers and Dominion in this case, the incontestable clause is to be found. Obviously, the insured does not need the clause to protect him in such an instance. He is insuring against the hazards of longevity, not premature death. So far, no company has ever tried to void an annuity because of an applicant's fraudulent concealment of his *good* health.

Appellants submit that the insertion of the incontestable clause in annuity contracts merely demonstrates that the clause has become boilerplate that is traditionally inserted whether applicable or not. A comparable instance is provided by the thousands of printed

leases that are executed annually in Southern California and Arizona, each solemnly spelling out the duties of landlord and tenant with respect to the removal of snow on the sidewalk.

Simply because an inapplicable standard clause has been incorporated into a contract, its historical meaning has not been changed. However, the District Court reasoned otherwise and concluded that since the annuitants did not need the protection of incontestability, "therefore the incontestable clauses contained therein (in the annuities) are for the benefit of the issuing companies." [R. 58].

Appellants respectfully submit that it was error for the court below to take a standard boilerplate provision, historically designed to *protect* the insured, and to ascribe to it the power to *strike down* the insureds' claim for losses caused by the fraudulent and reckless misrepresentations of the companies' agents. The law does not permit a shield to be so readily transformed into a sword.

2. Legislative Action to Make Clause Mandatory.

After the Armstrong Investigation conducted in New York in 1906 by Charles Evans Hughes, various states enacted legislation *requiring* the inclusion of an incontestable clause *(The Life Insurance Contract,* Horne and Mansfield, 2nd ed. N.Y. 1948, p. 184).

Thus, in California the Insurance Code makes mandatory the insertion of an incontestable clause in burial insurance contracts (Sec. 10244), group life policies (Sec. 10206), fraternal benefit policies (Sec. 11066h) and disability insurance (Sec. 10350.2).

Clearly such legislation was enacted for the benefit of the unprotected layman, and was not designed to impose upon him a contractual bar to his prosecution of fraud upon its discovery.

In Joseph B. Maclean, *Life Insurance,* Seventh Edition, published by McGraw-Hill Book Company, Inc. (1951) the author says at p. 210:

> "The Incontestable Clause. The majority of the states require, and the policies of all companies provide, that they shall be incontestable after a stated period, usually either 1 or 2 years, from date of issue except for nonpayment of premiums. The reason for such a provision is found in the character of the life insurance contract. The contract is based on information supplied by the insured, and it is undesirable that the company's liability for payment be disputed after the insured is dead, when it may be difficult either to prove or to disprove the truth of statements made many years earlier."

II.

The Incontestable Clause Cannot Be Employed to Bar Recovery by the Insured Against an Insurer Who Has Defrauded Him.

In *Donohue v. New York Life Ins. Co.* (D. Conn.-Mar. 16, 1949), 9 F. R. D. 669, the defendant insurer was permitted to amend its answer to set up a special defense that the incontestability provision of the contract was a bar to plaintiff-insured's suit for reformation of the contract, based upon misrepresentations of the agent made 20 years before. Counsel for the company urged the District Court that leave to amend should be granted because this Court's decision in *Rich-*

ardson v. Travelers (supra) had just been called to their attention. *Richardson* had held that an incontestable clause was a good defense for the insured in a suit for reformation brought against him by his insurer. Leave to amend was granted but on September 23, 1949, the District Court ruled, 88 Fed. Supp. 594, 596, as follows:

> "Nor is dismissal here (for plaintiff's laches) to be construed as approval of the defense of incontestability. The incontestable clause is for the benefit of the insured. Even in jurisdictions which follow *Richardson v. Travelers Insurance Company*, 171 Fed. 2d 699, the clause should not be held to bar action *by the insured* for reformation." (Emphasis supplied.)

Many cases have arisen where the insured has prevailed over an insurer found guilty of fraudulent selling practices. In none of these is there any indication that the insurer raised the incontestable clause as a bar to the insured's recovery. Some of these cases are described below. [Appellants have omitted from this list those cases where the successful insured had instituted his action within two years of execution of the policy—the maximum period fixed by most incontestable policies.]

1. *Fawcett v. Sun Life Assur. Co. of Canada* (C. C. A. 10 1943), 135 F. 2d 544, 153 A. L. R. 533.

Plaintiff sought cancellation of a combination single premium assurance and annuity contract because it had been obtained by misrepresentation as to the taxability of the proceeds. The agents of defendant had represented that the Bureau of Internal Revenue had actually ruled the contracts were insurance and not

annuities and not, therefore, subject to estate tax. *No such ruling had been made.* The agents of the company had further stated that their attorneys had given the subject careful investigation; that their opinion could be relied upon, and that the opinion of the insured's attorney could not be relied upon. The question involved whether or not these representations were related only to matters of law and therefore not actionable or occupied a recognized exception to the rule because of the position of the speaker. The court resolved the question in favor of the insured holding: 1. That the false statement concerning the Bureau's ruling was one of fact, not law. 2. That the insured relied on these statements to his detriment. No mention of the incontestable clause as a defense was made in the decision.

2. *Stark v. Equitable Life* (1939), 205 Minn. 138, 285 N. W. 466.

Plaintiff sued the defendant insurance company to recover disability benefits due him under two life policies and for reinstatement of the policies which had been permitted to lapse. Defendant's agent had misrepresented that plaintiff had no valid claim for benefits under the policies because he was not confined to bed by his disability. Nine years after they were made, plaintiff discovered the falsity of the agent's statements and then brought suit. The defendant company contended that the agent's representation was a matter of law and not fact. The court ruled that misrepresentations of law are treated similarly to misrepresentations of fact where the person who misrepresents the law is learned in the field and has solicited the

trust and confidence of the party defrauded, or where the person misrepresenting the law stands in a fiduciary relationship with the person defrauded. The court held for the plaintiff insured. No mention of an incontestable clause as a defense is to be found in the decision.

3. *Forman v. Mutual Life Insurance Co.* (1917), 173 Ky. 547, 191 S. W. 285.

An authorized agent of the defendant insurance company attached a paper to the policy he sold plaintiff-insured. Defendant claimed this paper to be only an illustration of the dividends payable. Plaintiff claimed reliance upon the information in the paper and that he was induced to purchase the contract of insurance upon the truth of the statements contaned therein. The court held for the plaintiff, stating that if there is reasonable doubt as to the meaning of an insurance contract, the construction which should be adopted is one that carries out the understanding of the insured as to the meaning of the contract at the time of purchase, provided that it is fairly made to appear that his understanding of its meaning was produced by and based on representations and assurances in writing made to him by the company before or at the time the contract was executed, and that these representations and assurances were of such a nature as to reasonably induce the insured to believe that his understanding and construction of the contract would be carried out. In this case 20 years had elapsed from the purchase of the policy until the time of suit, yet no mention was made in the decision of any defense asserted by the defendant company on the basis of the incontestable clause.

4. *Rohrschneider v. Knickerbocker Life Ins. Co.* (1879), 78 N. Y. 216, 32 An. Rep. 290.

Defendant, in order to attract potential insurers, caused advertisements to be published and pamphlets to be issued, stating, in substance that it insured at half the cost in other companies, since one-half of its premiums could be paid by premium notes and that its dividends always had, and would continue to pay the notes. The dividends, as defendant's managers well knew, never had paid the premium notes and generally would fall much short of doing so. Plaintiff read the advertisements and received one of the pamphlets from an agent of the defendant; and, relying on these and other representations, took an endowment policy for $500.00 payable at her death or at the end of five years if she should then be living. During the five years she paid one-half the premiums in cash and gave her notes for the other half; at the end of each year, the note of the previous year was included in the new note. Only one small dividend was paid during the five years. At the end of the five years she demanded the $500.00, but defendant would only pay the difference between that sum and the amount of the last note. Held, that an action for fraud was maintainable, as there was a false representation of a specific fact material to the transaction; and that plaintiff was not estopped, by allowing the contract to run to maturity, from asserting the fraud, as there were no means of discovering it prior to that time. Although the policy was permitted to run to maturity, no mention was made in the decision of any attempted defense on the basis of an incontestability clause.

5. *Harwood v. Security Mutual Life Ins. Co.* (1928), 263 Mass. 341, 161 N. E. 589.

The insurance company falsely represented material facts as to the nature of the policy, and its wording did not disclose the falsity of the representation. The insured was thereby induced to purchase the policy and to pay premiums for a type of policy which he did not want and which was more costly than represented. Held: upon discovering the falsity of the representation the insured could rescind the contract and recover the premiums paid. Although this policy was in effect for 23 years, no mention was made in the decision of any defense offered by defendant based upon the incontestable clause.

III.

Ambiguities in a Policy Are to Be Construed in Favor of the Insured.

Since an insurance policy is drawn by the insurer and since the insurer is required to use such language as will make the provisions of the contract clear to the ordinary mind, any ambiguity, uncertainty, or reasonable doubt is to be resolved by a construction in favor of the insured.

> "If there is doubt whether the words of a contract of insurance were used in an enlarged or restrictive sense, other things being equal, that construction will be adopted which is most beneficial to the insured."
>
> *Pendell v. Westland Life Ins. Co.* (1950), 95 Cal. App. 2d 766.

This point is extensively annotated under Section 380 of Deering's Annotated California Insurance Code (1963 edition) Pars. 37, 41, pages 286-292.

In *Yoshida v. Liberty Mutual* (C. A. 9-1957), 240 F. 2d 824, 826 the rule is stated that:

> "This Court has recognized and adhered to the well-settled rule of construction that where ambiguity or uncertainty exists in an insurance contract, such ambiguity or uncertainty will be resolved adversely to the insurer."

In *Steven v. Fidelity & Cas. Co.* (1962), 58 Cal. 2d 862, 879, the court said:

> "In standardized contracts, such as the instant one (an insurance policy), which are made by parties of unequal bargaining strength, the California courts have long been disinclined to effectuate clauses of limitation of liability which are unclear, unexpected, inconspicuous or unconscionable."

IV.

An Appellate Court Is Not Bound by a Trial Court's Interpretation of an Uncertain or Ambiguous Contractual Term Where the Lower Court's Determination Was Made Without Resort to Extrinsic Evidence.

Where the problem is one of construction and the ultimate finding is a conclusion of law, the appellate court may substitute its own judgment for that of the trial court.

Bogardus v. Commissioner (1937), 302 U. S. 34, 39;

Prickett v. Royal Ins. Co. (1961), 56 Cal. 2d 234, 237, 86 A. L. R. 713;

5 C. J. S., 577 Appeal and Error, Par. 1454(a).

Conclusion.

The judgment below should be reversed and the District Court directed to proceed to try the case upon the merits.

Respectfully submitted,

KENNY, MORRIS & IBANEZ,
HURLEY and BIGLER,
By ROBERT W. KENNY,
Attorneys for the Appellants Newton.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ROBERT W. KENNY,
Attorney for Appellants Newton.